Editor's note; 81 I.D. 162

KIRKPATRICK OIL AND GAS COMPANY

IBLA 74-187 Decided April 9, 1974

Appeal from a decision of the Acting Director, Geological Survey, GS-52-O&G, refusing to approve a 640-acre communitization plan.

Affirmed.

Oil and Gas Leases: Generally--Oil and Gas Leases: Communitization Agreements

While the actions of a state, under its police powers, in establishing spacing units for oil and gas wells is a factor to be considered in determining the acceptability of a communitization agreement, the Department of the Interior reserves the final authority on approving communitization agreements affecting federal leases of oil and gas deposits.

15 IBLA 216

IBLA 74-187

Oil and Gas Leases: Communitization Agreements

Where evidence indicates that a producing well is an oil well, and that a single well under a 640-acre spacing agreement will not effectively recover available oil from the underlying pool, it is proper to refuse to approve a communitization agreement for such area.

Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Royalties

In the absence of an approved communitization agreement involving a federal oil and gas lease, production of oil and gas from such federal lease is wholly attributable to that lease for computation of royalty due to the United States.

APPEARANCES: John R. Robertson, Jr., Esq., of George, Kenan, Robertson & Lindsey, Oklahoma City, Oklahoma, for appellant.

15 IBLA 217

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Kirkpatrick Oil and Gas Company has appealed from a decision of the Acting Director, Geological Survey, dated July 17, 1973, in which he affirmed the refusal by Regional Oil and Gas Supervisor, Tulsa, Oklahoma, to approve a 640- acre communitization agreement embracing Kirkpatrick's oil and gas lease NM 025111-A (Okla.).

Oil and gas lease NM 025111 (Okla.) issued on May 1, 1959, for a primary term of five years and so long thereafter as oil or gas was produced in paying quantities. By partial assignment lease NM 025111-A (Okla.) was created, effective December 1, 1961. Oil and gas lease NM 025111-A consisted of 171.60 acres, described by metes and bounds, in sec. 3, T. 22 N., R. 14 W., I.M., Oklahoma. Upon proper application the lease was extended for an additional five years to April 30, 1969. Appellant acquired the lease by assignment effective February 1, 1969. By decision dated May 13, 1969, a partial assignment of the subject lease, aggregating 53.10 acres, more or less, was approved effective April 1, 1969. Both the new lease NM 025111-B (Okla.), and lease NM 025111-A (Okla.), were extended through March 31, 1971, pursuant to 43 CFR 3128.5(b) (now 43 CFR 3107.6-2). Lease NM 025111-A (Okla.) contained 98.71 acres, more or less.

On March 19, 1971, appellant completed a producing well, Hepner 1-3, with an initial production of 136 barrels of 39.1 degrees gravity oil with 1,150 MCF of gas per day. This production was achieved from the Mississippi Lime formation at a depth of 7,110 to 7,750 feet. The resultant gas-oil ratio [GOR] was thus 8,450:1 in cubic feet of gas per barrel of oil. By letter of July 29, 1971, appellant submitted a proposed communitization agreement embracing all of section 3. By letter dated August 6, 1971, the Regional Oil and Gas Supervisor informed appellant that the proposed communitization agreement was unacceptable and returned unexecuted copies thereof. This rejection was premised on classification by the Geological Survey of the subject well as an oil well, and a finding that 640-acre spacing for oil wells did not adequately protect the public interest. The decision also informed appellant that until an acceptable communitization plan was proposed, appellant would be obligated to pay full federal royalties on its production. Kirkpatrick appealed from this determination. By decision dated July 17, 1973, the Acting Director, Geological Survey, affirmed the decision of the Regional Oil and Gas Supervisor.

On appeal to this Board the appellant reiterates the arguments presented to the Acting Director, Geological Survey. Central to its contentions is the action of the State of Oklahoma Corporation Commission establishing a 640-acre spacing unit for section 3. On

April 25, 1969, pursuant to a request of appellant, the Corporation Commission established 640-acre spacing for a number of formations in various within Ts. 22, 23 N., R. 14 W. This spacing was established because it was expected that natural gas would be the hydrocarbon encountered as the result of drilling a well, and that one well would adequately, economically and efficiently drain at least a drilling and spacing unit of 640 acres. Included in this order was the Mississippi formation in sec. 3, T. 22 N., R. 14 W., I.M., which embraced oil and gas lease NM 025111-A (Okla.).

Appellant, as a result of the Corporation Commission's action, is impaled on the horns of a dilemma, and as a practical matter contends that it is required to pay double royalties. Under the Corporation Commission's order of April 25, 1969, it is obligated to prorate production from its well to all the acreage in section 3. Under the decision of the Acting Director, Geological Survey, however, appellant must pay full federal royalties on the production taken from the federal leasehold. Thus, appellant is in the position of owing to the federal government royalty of 1/8th of 8/8ths production, in addition to its royalty obligations to the other royalty owners within the state approved spacing unit. 1/

1/ Sec. 2(d) of the federal oil and gas lease provides:

"Royalty on production--To pay the lessor 12 1/2 percent royalty on the production removed or sold from the leased lands computed in accordance with the Oil and Gas Operating Regulations (30 CFR Pt. 221)."

This case presents an issue of first impression before the Department and the initial question that must be faced is the authority of the federal government to utilize its own criteria for the approval of a communitization agreement involving a federal oil and gas lease. The resolution of this question entails an analysis of the interplay between the federal government's paramount authority over its oil and gas deposits and the exercise of a state's police power for conservation purposes.

That Congress is possessed of the power to exercise exclusive control over federal property is clear from a reading of Article IV, section 3, clause 2, of the United States Constitution. 2/ But it does not necessarily follow that Congress has preempted all state regulation of oil and gas deposits in federal lands. Particularly, in the area of state police power, it has been held that until such time as Congress has determined to deal exclusively with the subject, state law extends over the public domain. See Colorado v. Toll, 268 U.S. 228 (1925); McKelvey v. United States, 260 U.S.

---

fn. 1 cont.

Appellant contends that its outstanding royalty obligation to the remaining royalty owners is 9.2549 percent. Thus its royalty obligations aggregate 21.75492 percent. We would also note that appellant contends that the actual acreage in the section is 641.444 acres. Inasmuch as the exact acreage in the section is immaterial to our disposition of this case, we make no finding on this contention.

2/ Article IV, sec. 3, clause 2, provides:

"Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; * * *."

353 (1922); Omaechevarria v. Idaho, 246 U.S. 343 (1918); Texas Oil and Gas Corp. v. Phillips Petroleum Co., 277 F. Supp. 366, 369 (D. Okla. 1967), aff'd, 406 F.2d 1303 (10th Cir. 1969), cert. denied, 396 U.S. 829 (1969).

The applicable federal statute, section 17 of the Mineral Leasing Act, as amended, 30 U.S.C. § 226(j), provides in relevant part, that:

> [w]hen separate tracts cannot be independently developed and operated in conformity with an established well-spacing or development program, any lease, or a portion thereof, may be pooled with other lands, whether or not owned by the United States, under a communitization or drilling agreement providing for an apportionment of production or royalties among the separate tracts of land comprising the drilling or spacing unit when determined by the Secretary of the Interior to be in the public interest, and operations or production pursuant to such an agreement shall be deemed to be operations or production as to each such lease committed thereto.

The critical question is whether the above-quoted statute is indicative of a Congressional preemption of state regulation in the area of communitization or drilling agreements affecting federal leases. We believe that it is. We find support for this view in the opinion of District Judge Daugherty in Texas Oil and Gas Corp. v. Phillips Petroleum Co., supra.

In that case, Texas Oil and Gas Corporation and John H. Hill, owners of federal oil and gas leases, sought to quite title in lands under lease to them by seeking a declaration that a forced pooling order by the Oklahoma Corporation Commission was null and void, as applied to the federal lands. They argued, inter alia, that the federal government was vested with exclusive control over the federal lands. The court rejected any notion of a blanket preemption, but held that in two areas Congress had imposed "significant controls which must be satisfied before the State police power in the area of conservation may ultimately attach." Id. at 369. The first of these was that a federal mineral lessee could not assign his lease without the consent of the federal government, citing 30 U.S.C. § 187. The second condition is of direct bearing on the instant appeal, namely, that "a pooling or communitization agreement involving federal and non-federal lands must be approved by the Federal Government." Id. Though the Court refused to grant plaintiffs the requested relief, its decision was premised on the fact that:

> * * * the evidence herein reveals without dispute that the federal government approved the transfer of the working interests involved herein to the Defendant by the forced pooling Order of the Oklahoma Corporation Commission and approved the communitization of the leases in the spacing unit prescribed by the Oklahoma Corporation Commission. Thus, these limited controls established by Congress have been fully satisfied in this case. (Emphasis added.) Id. at 369.

The difference between Texas Oil and Gas Corp., supra, and the instant case is precisely the fact that the federal government has not approved the communitization of the leases in the spacing unit prescribed by the Oklahoma Corporation Commission. We think it clear that the federal government is under no obligation to accede to spacing orders issued under a state's police powers for conservation purposes, when the responsible federal official feels that it would not be in the public interest. A subsidiary question, however, and one which appellant vigorously presses, is whether or not, given the facts of this case, failure to accept the state's 640-acre spacing order is an abuse of discretion.

In its appeal before the Acting Director, Geological Survey, and again before this Board, appellant advances three arguments:

> 1. The decision is based upon the false premise that the order of the Oklahoma Corporation Commission creating the 640-acre drilling and spacing unit is in error and should be deleted, and that 80-acre drilling and spacing units should be established in place of such 640-acre unit.
>
> 2. The decision is based upon the false premise that a particular drilling and spacing unit established by the Corporation Commission of Oklahoma and existing by virtue of the laws of this state is against the public interest.
>
> 3. The decision requires Kirkpatrick to "serve two masters," one the State of Oklahoma, the second, the United States of America, without benefit of relief from either.

In support of its first argument Kirkpatrick points to a number of considerations. It argues, in effect, that the original decision of the Oklahoma Corporation Commission was correct, that in the proceedings before it, undertaken pursuant to 52 O.S. § 87.1 (1971), the Corporation Commission considered a variety of factors before making its determination, 3/ among which were economic factors, that the Mississippi Lime was actually a secondary producing zone (the Hunton zone being the primary zone for Hepner 1-3) and that no primary well could be drilled, on an economic basis, for the purpose of developing the Mississippi Lime reservoir.

We feel, however, that, in a very real sense, the thrust of appellant's comments is misdirected. This Board is not passing on the reasonableness of the Corporation Commission's decision, but on that of the Acting Director, Geological Survey. Though it is obvious, we think it worthy of special notice that the decision of the

3/ 52 O.S. § 87.1(b) (1971) declares that information on the following facts, among others, shall be material in the actions of the Corporation Commission in establishing a well-spacing unit:

"(1) The lands embraced in the actual or prospective common source of supply; (2) the plan of well spacing then being employed or contemplated in said source of supply; (3) the depth at which production from said common source of supply has been or is expected to be found; (4) the nature and character of the producing or prospective producing formation or formations; (5) any other available geological or scientific data pertaining to said actual or prospective source of supply which may be probative value to said Commission in determining the proper spacing and well drilling unit therefor, with due and relative allowance for the correlative rights and obligations of the producers and royalty owners interested therein."

Acting Director was, to a large extent, premised on information not available when the Corporation Commission established a 640-acre spacing unit, viz., the result of actual production from Hepner 1-3. As was noted above, initial production showed a GOR of 8,450:1. Subsequent production indicates that the ratio has declined to a GOR between 6,000:1 and 7,000:1. The oil has a corrected gravity of 39.9 degrees to 37.1 degrees API.

There is no federal definition of what constitutes an oil well as opposed to a gas well. This lack of a ready-made formula does not, however, bar intelligent classification. In certain states there are statutory definitions. Thus, for example, Texas defines an oil well as "any well which produces one (1) barrel or more of crude petroleum oil to each one hundred thousand (100,000) cubic feet of natural gas." Tex. Rev. Civ. Stat. Ann. Art. 6008 s 2(e). On the opposite end of the spectrum, the Court of Appeals for the Tenth Circuit has held that a well which produces "liquid hydrocarbons of 50 degrees or higher gravity" is classified as a gas well in Oklahoma. Diggs v. Cities Service Oil Co., 241 F.2d 425, 427 (10th Cir. 1957).

We are not disposed to establish any hard and fast rules as to what is or is not an oil well. Nevertheless, we are in agreement with the Geological Survey that the recorded production clearly

indicates that Hepner 1-3 is an oil well and not a gas well. 4/ This being the case we reach a second question as to whether it is proper to reject a 640-acre communitization agreement for oil production.

This really is a question of whether one oil well can efficiently drain a 640- acre tract. There are no set rules as regards the proper spacing of oil wells. Nevertheless, we are of the opinion that a communitization agreement, embracing an entire section of 640 acres, would not adequately drain that area. Furthermore, Oklahoma law provides that the Corporation Commission "shall not establish well spacing units of more than eighty (80) acres in size covering common sources of supply of oil the top of which lies less than 9,990 feet and more than 4,000 feet below the surface as determined by the original or discovery well in said common source of supply." 52 O.S. § 87.1(c) (1971). Implicit in this statute is a recognition that an oil pool cannot be adequately drained under spacing of more than 80 acres. The issue before

4/ We note that the GOR of offset wells indicate a much higher ratio of gas to oil than that found in sec. 3. Thus, in sec. 33, T. 23 N., R. 14 W., the GOR is 44,600:1, in sec. 34, T. 23 N., R. 14 W., the GOR is 61,000:1, and in sec. 4, T. 22 N., R. 14 W., the GOR is 67,900:1. The GOR of offset wells is amenable to a number of divergent interpretations. It could be argued that the comparative GOR indicates that the Hepner 1-3 is aberrational. Just as easily it could be contended that the Hepner 1-3 shows the limits of the gas deposit in the area. We are thus unable to give much weight to the GOR's of the offset wells.

this Board is not the question of what spacing would adequately recover the optimum quantity of oil, but rather whether a 640-acre spacing would be sufficient. We agree with the Acting Director that 640-acre spacing for the oil production shown in this case is inadequate for efficient recovery of maximum quantity of oil from the pool.

Appellant's second contention, though similar to its first argument, has a slightly different focus. It maintains that the Acting Director's decision is based upon a false premise that the 640-acre spacing unit is against the public interest. Appellant argues, in effect, that the only interest which the federal government is protecting is its own royalty interest and that "public interest" embraces more than simple income flow to the government.

The concept of public interest is both broad and ephemeral. We agree that it is not limited to economic return to the government. The difficulty with appellant's position, however, is that it misconceives the legitimate basis which motivated the Acting Director, Geological Survey. The decision reached was based on the public interest in attaining optimal development of energy resources. Perceptions of optimum conditions may differ, but given the facts of this case, we agree with the Acting Director that a 640-acre communitization agreement would not further the goals of proper development and the prevention of waste.

Finally, appellant complains of the fact that it must serv two masters without benefit of relief from either. We have indicated above that we are not unmindful of appellant's difficulties. Nevertheless, we are constrained to point out that there is an avenue of relief which appellant has foreborne from utilizing. Section 87.1(a) of chapter 52 of Oklahoma Statutes (1971) provides, in relevant part:

> * * * that the Commission may authorize the drilling of an additional well or wells on any spacing and drilling unit or units or any portion or portions thereof or may establish, reestablish, or reform well spacing and drilling units of different sizes and shapes when the Commission determines that a common source of supply contains predominantly oil underlying an area or areas and contains predominantly gas underlying a different area or areas; * * *.

This section also provides a procedural mechanism for obtaining this relief.

Appellant points out the fact that it is not obligated to seek such relief. That may well be the case. But appellant can scarcely be heard to argue that its refusal to seek relief means that no relief is available, or that the United States must abandon its position to provide such relief. 5/

5/ We are not unaware that decisions of the Oklahoma Supreme Court indicate that there must be a substantial change of conditions or

Appellant requests, in the alternative, that if this Board affirms the Acting Director's action in refusing to approve a 640-acre communitization agreement, that the communitization agreement be treated as executed from the date of first production until a despacing order can be obtained from the Oklahoma Corporation Commission. Inasmuch as we have held that the Acting Director properly refused to approve the 640-acre communitization agreement we can perceive no grounds upon which the requested relief could be granted. In the absence of an approved communitization agreement full royalty payment to the United States must be made in accordance with the terms of lease NM 025111 (Okla.). Appellant elected to pursue this appeal rather than seek a despacing order. The consequences of this choice must be borne by appellant.

Appellant has requested oral argument. As it is the opinion of this Board, in view of our conclusions, that oral argument would serve no useful purpose, and would merely retard speedy disposition of this case, which appellant has requested, the same is hereby denied. 43 CFR 4.25.

---

fn. 5 cont.
knowledge of conditions in an area before the Corporation Commission can entertain an application to modify a spacing order. Phillips Petroleum Co., v. Corporation Commission, 482 P.2d 607 (Okla. 1971); Cameron v. Corporation Commission, 414 P.2d 266 (Okla. 1966). We are unaware of any decision, however, that would indicate that the information obtained since the completion of the well would be insufficient to allow the granting of a despacing application if the Commission were so disposed.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Douglas E. Henriques
Administrative Judge

We concur:

Edward W. Stuebing
Administrative Judge

Joan B. Thompson
Administrative Judge